

Towards a Euro Union

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Crisis, what crisis?

If public sentiment in Germany is anything to go by, there is little reason to worry about Europe. The period when it was feared that the euro might collapse seems a long time ago. Financial markets have calmed down. The design flaws of the monetary union seem to have been papered over, and European Council President Herman van Rompuy was able to claim, unchallenged, before the UN General Assembly in New York that the "existential threat to the euro" is over.

We think this is fundamentally wrong. There is no reason to relax the guard. On the contrary, the complacency of large sections of the German public with regard to the euro crisis is not only unfounded: it is dangerous. None of the fundamental problems underlying the euro crisis have been solved – not the banking crisis, nor the sovereign debt crisis, nor the competitiveness crisis. National debt problems continue to escalate. Banks are overloaded with bad loans, crippling the private sector. In the crisis countries, a generation is being deprived of its livelihoods and opportunities. The margins of the political spectrum in these countries are becoming increasingly radicalized. And willingness to find common solutions for the euro area appears to be rapidly on the wane.

We – eleven German economists, lawyers and political scientists – cannot accept the prospect of further playing for time and betting – with ever-larger wagers – that the crisis will eventually pass. Europe has structural problems that require structural solutions. Even though this is not a popular view at the moment, we are convinced that the monetary union needs deeper integration. More particularly, it needs a sufficiently powerful European economic government.

We speak as German but also as EU citizens who are connected with other EU citizens in a community. This is no contradiction: it is in Germany's self-interest to overcome fears about a transfer union and to stop dismissing any constructive proposal as an attempt to pull the money out of German pockets.

The no-bailout principle, which states that no state is allowed to save another from bankruptcy, was right. But if its enforcement causes incalculable damage, neither debtors nor creditors will believe the assertion that states must take direct responsibility for themselves. The architecture of the euro area can only be sound and stable if it prevents such collateral damage. That requires deeper integration, in four areas.

1. Responsible debtors need responsible creditors

The Maastricht Treaty assumed that common debt rules would solve the problem of the irresponsible building up of debt. Greece showed this to be a delusion. Therefore, it was right to toughen sovereign debt rules with the fiscal pact. But it is also true that the crisis would not have been prevented by the fiscal pact itself in countries like Spain and Ireland. The fiscal risks that piled up in those countries were ultimately caused by excessive private sector debt.

Whether the indebtedness is public or private, it becomes a problem for the monetary union only if private creditors do not write off their losses on their own account, but socialise them. But that is exactly what happened: the debts of financial institutions, and of banks in particular, were socialised. The banks were able to do so because they knew that their systemic importance would give the European taxpayer no choice but to save them.

To put a stop to this game once and for all, the euro area needs a robust banking union. The single banking supervisor must ensure that the banking sector has a solid capital base. The common bank restructuring mechanism must make creditors accountable: if banks suffer large losses, first shareholders must fill the gap, then subordinated bondholders, thereafter senior creditors and lastly the bank funds financed by the banks themselves. Only when these options have been exhausted, should there be resort to the European taxpayer.

In principle, the European Council recognised all of this in the summer of 2012. But we predict that implementation will fail by the spring of 2014. As of May 2014, the European Single Supervisory Mechanism will perform stress tests and should show the red card to ailing banks. But how will this work, if no one knows how banks are to be recapitalised or liquidated in an emergency? Without a resolution mechanism, the supervisors will continue to sweep bank balance sheet problems under the carpet and Europe will face a Japanese-style decade of economic stagnation. Time is pressing. The 2014 European elections must not be an excuse for delaying solutions to the structural problems in the euro area.

2. Responsibility and solidarity go hand in hand

The responsibility of member states entails the responsibility of their taxpayers. It is therefore inevitable that taxpayers will have to shoulder a large share of the burdens of the crisis, and suffer painful reforms. But the limit of responsibility when livelihoods are threatened. If in Greece, Portugal or Spain, a whole generation is deprived of their chance to live a productive life, it is not just a Greek, Portuguese or Spanish problem, but one that affects us all as citizens of the EU.

The monetary union cannot be permanently stable without a controlled transfer mechanism. Situations in which a euro-area country suffers an acute liquidity emergency and is forced to enact draconian austerity measures on its population must remain exceptional. To prevent such extremes, we need a euro-area insurance mechanism to cushion the fiscal consequences of a dramatic economic downturn.

The euro area could therefore establish a common unemployment insurance system, to complement national systems; all countries that organise their labour market in line with the needs of the monetary union could be eligible for participation. This would create a mechanism to counteract deep recessions with automatic European stabilisers. Thus, the macro-economic cohesion of the euro area could be strengthened and the integration of the European labour market accelerated.

In fact, more labour mobility in the monetary union is urgently needed. Germany should not have to complain about a lack of skilled workers when many skilled workers are unemployed in Spain. The unemployed in crisis countries should be enabled to find work in other euro-area countries by attending language courses and being offered other training.

Moreover, in the current low interest rate environment, countries such as Germany would be well advised to invest in their own infrastructure and, thereby, to create demand across the euro area.

3. Democracy and rule of law must be strengthened

In a Union, member states must mutually be able to rely on the fact that their governments are legitimately elected, their laws legitimately written and their citizens free and equal before the law. Potential members must therefore accept that they will be reviewed in depth on their democratic, constitutional, and fundamental rights standards. By joining, a state takes on the obligation to continue to comply with these standards. But the EU lacks effective and credible instruments to enforce this obligation – as in the case of Hungary.

This can become especially problematic if a member states goes through a severe economic crisis. Experience shows that such crises radicalise societies and threaten democratic institutions.

It is unacceptable that the EU can more effectively enforce state aid breaches than breaches of democratic or constitutional rules. The EU must be equipped with a sanctions mechanism to ensure that member states can rely on each other and that their citizens are not defenceless against the undermining of their constitutional orders.

The European Union is a community of law. The authority of European law depends on the functioning of the legislative, the executive and the judiciary in member states. Where they do not, the Union's foundations are threatened. Promoting effective rule of law should therefore be a much higher priority than, for instance, agricultural policy.

4. Cohesion: Public goods must be provided

Political unions can provide public goods that each country would not be able to provide on its own. The original driver for European integration was securing the peace. Effective protection of external borders, humanitarian treatment of refugees

and asylum seekers in the Schengen area, internal markets and the protection of our environment are also public goods that the EU is committed to provide. Providing a stable common currency is a public good for the euro area.

The limit of member states' responsibilities in a crisis are reached when the provision of such public goods is in danger. If a member state can, for example, no longer ensure airport security, it will harm European air transport as a whole. If a member state subjects asylum seekers to inhumane conditions, the European asylum system breaks down. If crisis countries begin to close their markets to protect domestic manufacturers, the internal market and common commercial policy are threatened. If the economic crisis in a member state reaches the point where financial markets speculate on its exit from the monetary union, then this can destroy the common currency.

The provision of these public goods must always function independently of the possible bankruptcy of a member country. That does not mean that their provision must be completely centralised. It may be sufficient to enable the EU to step in to provide support in a crisis. The EU does not need to begin to build decent accommodation for asylum seekers, but it must at least financially support those states that cannot achieve this on their own.

These four points – the responsibility of creditors, protection of opportunities, protection of democracy and rule of law, and preservation of public goods – are the minimum required to keep the euro alive. But more needs to be done to develop the full potential of the EU. The EU must exploit promote common public goods for the benefit of all.

We see particular potential in the common foreign and security policy. In a multipolar world in which China, Russia and others expand their spheres of influence and the global supremacy of the USA decreases, Europe ought to be able to defend her common interests effectively. It should be possible for Europe to pursue a joint strategy on global trade and finance legislation as well as on the use of global commons such as the deep sea or outer space. It is self-evident that countries in the euro area with a common currency should also claim a common seat at the IMF and World Bank. Were there an effective common foreign policy and centralised decision-making structures for security policy, a joint seat at the UN Security Council would be achievable.

The challenges of the 21st century go beyond those of classical security and foreign policy. The NSA affair has shown, for instance, that EU citizens cannot expect states to protect their privacy. What is needed is a European market for data security, one that defines strict internet privacy and encryption standards and enforces these within the scope of agreements with third countries, instead of overturning them through intelligence cooperation arrangements. Ideally, these public goods should be developed for the European Union as a whole, including the United Kingdom. Inasmuch as this turns out to be impossible, however, the euro area should retain the strategic option of a Europe of different speeds in these areas.

A Euro-Treaty for the Euro-Union

To achieve this political agenda, the euro area needs a new contractual basis of its own. What is called for now is a Euro-treaty to replace previous piecemeal reforms. With such a contract, collective insights and experiences from the crisis would be stored permanently. A Euro-treaty would re-focus public debate on Europe's political needs and wishes, away from the current preoccupation with what is legally feasible. The issue of amendments to Germany's Basic Law, which may be required in the context of further EU integration, would finally be discussed specifically with reference to the Euro-treaty.

The idea of a Europe of different speeds is not new. The euro crisis has shown, however, that such a deepening should include the entire euro area. In order to avoid a division of Europe, the interests of all member states ought to be considered, especially the smaller ones.

In dealing with the euro crisis, heads of state and government have so far set the tone. But this *intergovernmentalism* is not up to the tasks that need to be done in a monetary union. This is a key reason why the European Central Bank has, willy-nilly, seen itself compelled to take on such a central role in preserving the common currency.

We finally need a European executive that can negotiate reform packages with crisis countries, decide on bank closures and ensure the provision of public goods. The Euro Union needs an economic government capable of acting.

This economic government should have graduated rights of intervention in national budgetary autonomy. As long as member states comply with their obligations, this may involve only non-binding recommendations. If a member state, however, violates the stability criteria, the economic government must be able to make binding stipulations of how much the state has to save – the state will keep the decision where to save.

The economic government also needs a budget for the promotion of public goods, as well a growth fund to support reform processes in euro-area countries. In principle, it would be possible to finance this budget through taxation. But there are good reasons not to give the economic government extensive access to the European tax base. It makes sense to finance the euro-budget through a membership fee, in the amount of about 0.5 per cent of the gross domestic product.

The Euro-government must be chosen and scrutinised by a Euro-Parliament. It stands to reason to staff this body with deputies from the European Parliament representing euro-area countries, since its purpose is the provision of public goods in the euro area. There are also voices in our group, however, that prefer the Euro-Parliament to be made up from members of national parliaments, to ensure that control over governmental spending remains in their hands.

Either way, countries that are planning to introduce the euro in the near future ("pre-ins") should be involved in the negotiation of the Euro-treaty from the outset. This

also applies to the institutions of the Euro-Union – through a representation with the right to speak but no voting power.

No one should succumb to the fallacy that the crisis will fade away and that the stabilizing mechanisms that have been hastily cobbled together will suffice to make the euro a long-term success. One of the founding fathers of the European Union, Jean Monnet, once said: "L'Europe se fera dans les crises". The current crisis is probably the greatest that the Union has had to endure in its history. It now depends on us to use this historic opportunity.

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